Texas Department of Transportation

TESTIMONY

Transportation Funding and the Federal Funding Process: Rate of Return, Rescissions and More

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Introduction

Transportation funding continues to remain unstable and unable to meet the growing infrastructure and mobility challenges facing our growing state. In researching proposals to address the funding challenges facing Texas, it is important to provide an overview of current funding options and the effectiveness and efficiencies of those options.

Federal Highway Funding

Federal Funds are a primary source of revenue for the State Highway Fund; making up either the largest or second largest source of the fund's income every fiscal year since 1999. Federal transportation funding is primarily allocated from the Federal Highway Trust Fund, which is capitalized from federal gasoline and diesel taxes; truck, bus, and trailer taxes; tire taxes; heavy vehicle usage fees; and taxes on alternative fuels.

Texas is considered a donor state, meaning more money is deposited to the Federal Highway Trust Fund from the collection of federal taxes and fees in Texas than is returned to the state in federal funds for highways. According to the Federal Highway Administration, Texas is ranked last in receipts it receives compared to contributions made to the fund.

Definitions

Following are some terms you will see regularly throughout this testimony:

SAFETEA-LU: The federal surface transportation authorization act covering the period from 2005 to 2009. The act establishes each state's yearly apportionment which functions similar to a ceiling on the amount of obligation authority that may be allocated in annual appropriation bills. The Act expired on September 1, 2009. Congress recently extended the program through December of 2010, but there has been little movement in Congress to reauthorize these programs. Instead, states are operating under a series of continuing resolutions (CRs) that will parcel out obligation authority in increments measured in days, weeks, or months. To date there have been six continuing resolutions, and the current resolution lasts through December 31, 2010 funding the federal program for all of Federal Fiscal Year (FFY) 2010 and through the first quarter of FFY 2011. We do not know how long the next CR will last and therefore we do not know how much obligation authority will be provided.

Highway Trust Fund: The source of funding for most surface transportation programs. There is a \$0.184 per gallon tax on gasoline and a \$0.244 per gallon tax on diesel fuel. The fund is composed of the Highway Account, which funds highway and intermodal programs, and the Mass Transit Account. Federal motor fuel taxes are the major source of income into the fund.

Apportionment: Also known as “contract authority,” apportionment is unfunded and requires an appropriation to make payments. In 2010, TxDOT's apportionment under the extension of SAFETEA-LU provisions is $3,336,496,373.

Obligation Authority: Also known as ‘‘budget authority,’’ obligation authority is the authority provided by federal law to make funds available for obligation and expenditure.[1] With regard to the federal-aid highway program, obligation authority often refers to the amount of federal-aid obligation limitation, established annually by Congress in appropriation acts, that is allocated to the states and controls the amount of apportioned contract authority that can be obligated by the states in a given fiscal year.[2] In 2010, TxDOT's obligation authority, as established by congressional appropriation, was $2,679,963,888.

Reimbursements: After receiving its obligation authority, TxDOT may enter into contracts for projects. The appropriation made by the Texas Legislature includes a line in TxDOT's Method of Finance called “Federal Reimbursements.” This is an estimate of the actual cash TxDOT will receive during the biennium as reimbursements from the federal government which can be used to make payments on other projects.

Equity Bonus: The Equity Bonus funding category increases a state’s apportionment to ensure that it reaches a certain minimum rate of return on contributions to the Highway Account of the Highway Trust Fund. Prior to the enactment of SAFETEA-LU, this program was called the Minimum Guarantee program. The equity bonus category is important because it carries with it its own obligation authority. Rescissions from this category of funding also reduce obligation authority. This category also is the most flexible in that the funding can be used for most federal-aid projects, whereas, for example, the bridge category can only be spent on bridges.

Rescissions: Legislation enacted by Congress that cancels the availability of budget authority previously enacted. Rescissions typically target “unobligated funds,” however in recent years rescissions have impacted TxDOT's obligation authority and therefore they have also impacted our ability to award projects.

Federal Funding Mechanisms

The majority of federal transportation funding provided to TxDOT is for highway planning and construction. Most of the federal funds provided for highways are through programs that require the state to provide matching funds. In rare instances, funds are provided for events such as natural disasters that do not require a match.

Federal funds are typically provided to states as a reimbursement for expenditures the state has already made on transportation projects. For example, on federally approved projects, a contractor performs road construction or maintenance and is paid by TxDOT for the work. TxDOT then bills FHWA for the federal share of the project and is reimbursed. Once federal funds are obligated, the reimbursement process continues for the length of the

[1] 2USC § 622, “Congressional Budget and Impoundment Control Act of 1974”
[2] Glossary, AASHTO Center for Excellence in Project Finance

project which can take several years. Therefore, federal fund amounts presented in TxDOT's budget represent projected reimbursements from existing and future obligations.

Section 7-b, Article 8 of the Texas Constitution provides that federal reimbursements for state funds dedicated by the state constitution are also constitutionally dedicated to those purposes. Chapter 222, Subchapter B of the Texas Transportation Code gives statutory guidance for the use of Federal Funds for transportation. This chapter requires that all federal funding appropriated to Texas for public road construction be spent by or under the supervision of TxDOT. The Texas Transportation Commission (Commission) is required to distribute federal aid for transportation through selecting highway projects that meet requirements established by federal formulas.

The federal government has also established several new financing mechanisms that states may use to more quickly generate funds for highway construction and maintenance. Any surface transportation project eligible for federal funds may use private-activity bonds issued through a public entity after the federal government has allocated funds for that purpose. Private activity bonds are intended to incentivize the private sector to participate in financing projects by providing a tax exemption on interest earned from bond proceeds.

Also, the federal government created the State Infrastructure Bank (SIB) as a pilot program in 1995, and Texas was chosen as one of 10 states in which to test the program. The creation of Texas' SIB was authorized by the state legislature in 1997. The SIB is overseen by the Commission and operates as a revolving loan program in the State Highway Fund which provides lower interest rates to local entities constructing federally eligible surface transportation projects.

Lastly, the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA) was created which allowed the U.S. Department of Transportation to provide secured loans, loan guarantees, and standby lines of credit to major surface transportation projects. These forms of credit are intended to generate private and non-federal co-investment in projects improving the surface transportation system. The Central Texas Turnpike System (Loop 1, SH 45N, and SH 130 Segments 1-4), US 183-A, and SH 130 Segments 5 and 6 received TIFIA assistance.

Rate of Return

The state-federal partnership that delivers the nation's transportation infrastructure is essential to achieving our national, state, and regional mobility goals, and the federal-aid funds the state receives for highway and transit projects and programs are essential for meeting our transportation mobility needs. However, Texas suffers from a low rate of return, meaning we receive back far less than we contribute to the highway trust fund.

The formula created in SAFETEA-LU states that when a gas tax dollar is sent to Washington, 84.5 cents of it goes into the highway account and 15 cents goes into the transit account. One-half of a penny goes to other purposes. This is true for all states not just Texas.

Calculating rate of return is a complicated undertaking. It involves percentages and percentages of percentages. There have been tremendous efforts to improve the equity of the federal-aid highway program and the general perception is that Texas gets a 92% return of all federal gas tax payments. However, in general, for every dollar Texans contributes to the federal Highway Trust Fund, Texas gets back only +/- 8¢ in federal transit program funds and only +/- 70¢ in federal highway program funds. The remaining Texas federal motor fuels tax dollar is sent to other states.

The following diagram shows the data from the Federal Highway Administration that leads to this calculation for highways. By calculating the percent received vs. the percent contributed, you get a partial rate of return for money deposited to the highway account. To get to a complete rate of return for motor fuel taxes just for highways you have to acknowledge that some of the fuel taxes go to the transit account. For example, if you get an 81% return on 85% of the funds that equals a return of near 70% for highways.

CHART 1: Rate of Return Calculation

Comparison of Federal Highway Trust Fund Highway Account Receipts Attributable to the States and Federal-Aid Apportionments and Allocations from the Highway Account

Data	Deposits			Uses			Partial ROR of Hwy Acct	% of Fuel Taxes Deposited to Hwy Acct	ROR of Fuel Taxes for Hwys
	Nation	Texas	Tx %	Nation	Texas	Tx %			
2008	31,341,702	2,921,406	9.32%	41,304,449	3,120,314	7.55%	81.01%	85.09%	68.93%
2007	34,899,255	3,202,376	9.18%	41,809,281	3,216,831	7.69%	83.77%	85.51%	71.63%
									70.28% Avg

Source: Table FE-221 Federal Highway Administration *Highway Statistics*

Calculated % of %

Calculated % of %

Source: Table FE-9 Federal Highway Administration *Highway Statistics*

Federal Rescissions

Texas relies heavily on federal funds to help address the state's transportation needs. However, federal funding is increasingly unreliable, due to the expiration of the federal-aid program, the insolvency of the Federal Highway Trust Fund, and the lack of clear goals and strategies for transportation at the federal level. This lack of reliability has also played out during the last four years with a total of eight rescissions.

A rescission is legislation enacted by Congress that cancels the availability of budget authority previously enacted.[3] While the concept of rescissions is not new, the frequency of rescissions since 2006 and the willingness of Congress to remove the flexibility with which states may handle rescissions have increased. TxDOT acted to minimize the impact of rescissions on Texas drivers, but continued obstacles made this a challenge.

Highway projects take many years to develop from the moment a need is detected to the point at which the contractors are paid and the road is open to traffic. Project development does not occur neatly within the yearly appropriations cycle at the federal level. Recognizing this situation, Congress provides varying levels of authority to states to plan, program, and finance projects.

Rescissions since Enactment of SAFETEA-LU
Below is a chart showing all of the rescissions that have occurred since the enactment of SAFETEA-LU

Chart 2: Rescissions

FY 2006	TxDOT	Nationwide	TxDOTs %	Signed into law
TTHUD	$158,707,654	$1,999,999,000	7.94%	11/30/2005
Defense	$90,670,526	$1,143,000,000	7.93%	12/30/2005
Supplemental	$55,716,165	$702,362,500	7.93%	6/15/2006

FY 2007	TxDOT	Nationwide	TxDOTs %	Signed into law
Omnibus	$288,459,698	$3,471,582,000	8.31%	2/15/2007
Supplemental	$72,374,710	$871,022,000	8.31%	5/25/2007

FY 2008	TxDOT	Nationwide	TxDOTs %	Signed into law
Omnibus	$257,989,173	$3,150,000,000	8.19%	12/26/2007

FY 2009	TxDOT	Nationwide	TxDOTs %	Signed into law
Omnibus	$272,403,085	$3,150,000,000	8.65%	3/11/2009

[3] Financing Federal-Aid Highways, Federal Highway Administration, U.S. Department of Transportation, March 2007.

September 30, 2009	TxDOT	Nationwide	TxDOTs %	Signed into law
SAFETEA-LU	$742,240,415	$8,708,000,000	8.52%	8/10/2005

With respect to transportation, SAFETEA-LU essentially advises states to plan projects up to the amount of apportionment provided in the act. For the rescissions that occurred in 2006, 2007, and 2009, states had the flexibility to distribute the rescission among several categories of funding, within certain parameters, in order to minimize the impact of the reduced programming authority.

Change in Flexibility

In 2008 Congress passed the "Energy Independence Security Act" (EISA). As part of that act, Congress changed the way that some rescissions would be distributed. The EISA language required that states distribute the rescission proportionately across certain SAFETEA-LU programs. These programs include Interstate Maintenance, Highway Bridge, Equity Bonus, Transportation Enhancements, National Highway System, Congestion Mitigation and Air Quality, Highway Safety, Rail Crossings, Metro Planning, and various other Surface Transportation Programs including those that support Metropolitan Planning Organizations (MPOs).

A state may adjust the rescission distribution among these eligible programs so long as no program's rescission increases by more than 10%. Due to the rule change, the rescission contained in the FFY 2008 appropriations cycle caused us to rescind $13.5 million of Equity Bonus causing an equal reduction in actual obligation authority (i.e., our authority to enter into contracts), as opposed to unobligated planning dollars allocated through apportionment.

For the rescission that was to take effect at the end of SAFETEA-LU, TxDOT again did not have the same flexibility with which to administer the rescission as it had in the past. In addition, TxDOT was concerned about the uncertainty surrounding the continuance of the federal surface transportation program, which also expired on September 30. These circumstances presented two options to the department: 1) use existing obligation authority on active projects for reimbursement in future years thereby protecting it from the rescission but leaving less flexibility entering a period of uncertainty as Congress debates the next transportation bill; or 2) not utilize all existing obligation authority in an effort to retain some obligation authority to address new project-starts during the period of months, or even years, that Congress takes to reauthorize surface transportation programs, but exposing it to the rescission.

After several discussions and considerations of the options, TxDOT essentially selected Option 2. During this period of immense uncertainty with respect to the federal program, and during a crippling recession in which unemployment in the construction industry was nearly twice that of other sectors[4], TxDOT chose a course of action that will provide more stability and efficiency in project scheduling in exchange for the loss of obligation authority in 2009. When this decision was made there was also the chance that Congress

[4] 18.2% according to the Bureau of Labor Statistics, U.S. Department of Labor, November 6, 2009

would cancel the rescission. The SAFETEA-LU rescission resulted in a $103 million reduction in equity bonus obligation authority.

Since 2006, the total amount rescinded is $23.2 billion nationwide. For Texas, $1.9 billion has been rescinded. However, as part of H.R.2847, known as The "HIRE Act", the September 30th 2009, SAFETEA-LU rescission was restored, providing states with almost $8.4 billion in apportionment. While that was helpful, states were not given any new obligation authority to spend the funds. Texas received $742,240,415 in apportionment, but since obligation authority was not given we still lost $103 million in equity bonus.

Pass-Through Financing Program

Several programs authorized at the state level help to supplement the highway funding program. For example, Proposition 14 bonds, approved by voters in 2003; and Proposition 12 bonds, approved by voters in 2007, are two programs which have provided for additional opportunities for funding safety and mobility needs. Pass-through financing is another such tool the legislature created to allow local communities to fund upfront costs for constructing a state highway project. The state then reimburses a portion of the project cost to the community over time by paying a fee for each vehicle that drives on the new highway. Projects must be on the state highway system to be eligible to be developed under this program.

Beginning March 12, 2010, TxDOT started to accept proposal submissions for pass-through finance projects from both public and private entities according to the terms of our notice published in the Texas Register, a minute order on the program adopted by the Commission in February, and the program rules outlined in the Texas Administrative Code. Application guidelines are available through the department's website at www.txdot.gov and the deadline for submission of proposals is 3 p.m. on May 11, 2010.

The department has 17 pass-through projects with executed agreements, and 10 pass-through projects that have not yet been finalized but have received approval to execute agreements. To date, these 17 executed agreements have a pass-through amount valued at just over $1.4 billion. In addition, there is no requirement that a project participating in this program include a tolled component, and no project currently participating or planning to participate in the program are toll projects.

Conclusion

TxDOT continues to look to all federal and state funding options available to meet the ever-changing face on the transportation needs dominating our state. We stand ready to implement any laws enacted by the legislature and continue to work with our members at the federal level to identify our growing needs and possible funding opportunities.